



## Standard Simplified Employee Pension Plan Employee Information

### QUESTIONS AND ANSWERS

- 1. Q. What is a Simplified Employee Pension (SEP) plan?**

A. A SEP plan is a retirement income arrangement under which your Employer may contribute, generally in the form of discretionary contributions, certain amounts to your own Traditional individual retirement account or Traditional individual retirement annuity (IRA).

Your Employer will provide you with a copy of the *SEP Summary for Employees* containing participation requirements and a description of the basis upon which Employer contributions may be made to your IRA.

All amounts contributed to your IRA by your Employer belong to you, even after you leave the employment of that Employer.
- 2. Q. What are discretionary contributions?**

A. Discretionary contributions are contributions which may be made by your Employer for you to your IRA. Whether or not your Employer makes a discretionary contribution is entirely up to your Employer. If a discretionary contribution is made under the SEP Plan, it must be divided among all the eligible Employees according to the allocation formula your Employer has selected.
- 3. Q. What are fixed-percent-of-profits contributions?**

A. Fixed-percent-of-profits contributions are a percentage of company profits which are made to your IRA if your Employer has profits in excess of a stated dollar amount.
- 4. Q. How will contributions be allocated to my IRA?**

A. Refer to the *SEP Summary for Employees* to see whether your Employer has selected the pro rata, flat dollar, or integrated formula.

If your Employer has selected the pro rata formula, contributions on behalf of each eligible Employee will be the same percentage of compensation for all Employees.

If your Employer has selected the flat dollar formula, the Employer Contribution will be allocated equally resulting in each Employee receiving the same dollar amount.

If your Employer has selected the integrated formula, see Question 18.

When calculating contributions to be made to the SEP Plan, an Employee's Compensation above \$285,000 for 2020 and \$290,000 for 2021 will not be included. (This amount is increased by the IRS periodically based on changes in the cost of living.)

The law prohibits your Employer from making contributions which discriminate in favor of highly compensated Employees.
- 5. Q. Who are eligible Employees?**

A. Eligible Employees are Employees who have satisfied the minimum age, service, and Compensation requirements set by your Employer as specified in the *SEP Summary for Employees*. An Employee who satisfies those eligibility requirements is entitled to participate in the SEP Plan.
- 6. Q. How much may my Employer contribute to my IRA in any year?**

A. The amount of contributions for any year is limited to the lesser of \$40,000 or 25 percent of your Compensation for that year (\$57,000 for 2020 and \$58,000 for 2021). (This limitation may be increased by the IRS for changes in the cost of living.) The Compensation used to determine this limit does not include any amount which is contributed by your Employer as contributions to your IRA under the SEP Plan. Remember, if your Employer has chosen a discretionary contribution formula, the SEP plan does not require your Employer to maintain a particular level of discretionary contributions. It is possible that for a given year no discretionary contributions will be made on your behalf.
- 7. Q. How do I treat my Employer's SEP Plan contributions for my taxes?**

A. The amount your Employer contributes to the SEP Plan is excludable from your gross income (subject to the \$40,000 or 25 percent of Compensation limitation mentioned above) and is not includable as taxable wages on your Form W-2.
- 8. Q. May I also contribute to my IRA if I am a Participant in a SEP plan?**

A. Yes. You may still contribute the lesser of the applicable limit or 100 percent of your Compensation to an IRA. However, as a Participant in a SEP plan, you would be considered an active participant in an Employer-maintained retirement plan and, therefore, you may or may not be able to deduct your Traditional IRA contribution, depending upon your modified adjusted gross income, and which type of tax return you file (single individual, married filing jointly, or married filing separately). (You may, however, also be eligible to contribute to a Roth IRA.)
- 9. Q. What if I don't want an IRA?**

A. Under the tax rules which apply to SEP plans, for an Employer to have a valid SEP plan, all eligible Employees must establish IRAs. Your Employer may require that you become a Participant in the SEP Plan and set up an IRA as a condition of employment. If one or more eligible Employees do not participate and the Employer attempts to maintain a SEP plan with the remaining Employees, there may be adverse tax consequences for both the Employer and the Employees.
- 10. Q. Can I select the financial organization where I set up the IRA which is to receive the SEP Plan contributions made on my behalf?**

A. Generally, you may select the financial organization where you set up the IRA which is to receive SEP Plan contributions made on your behalf.
- 11. Q. Can I move assets from my IRA to another tax-deferred IRA?**

A. Yes. You can withdraw contributions from your IRA and, no more than 60 days after your receipt of the assets, place such assets into another IRA. This is called a "rollover" and may not be done without tax penalty more frequently than at one-year intervals. However, there are no restrictions on the number of times you may make "transfers" if you arrange to have such assets transferred directly between IRA trustees or custodians, so that you never have possession of the assets.
- 12. Q. What happens if I withdraw my Employer's contributions from my IRA?**

A. If you don't want to leave the Employer's discretionary contribution in your IRA, you may withdraw it at any time, but any amount withdrawn is includable in your income and will be taxed. Also, if you take withdrawals before you reach age 59½, and those withdrawals do not satisfy a penalty exception (e.g., due to disability), you may be subject to a 10 percent IRS penalty tax.

**13. Q. May I participate in a SEP plan even though I am covered by another plan?**

A. Yes. You can participate in a SEP plan (other than a SEP plan which uses the IRS’s model SEP plan document) even though you participate in another qualified retirement plan (such as a pension or profit sharing plan) of the same employer. However, the combined contribution limits are subject to certain limitations described in Section 415 of the Internal Revenue Code. Also, if you work for several employers, you may be covered by the SEP plan of one employer and a SEP, pension, or profit sharing plan of another employer.

**14. Q. What happens if my Employer makes too large of a contribution to my IRA in one year?**

A. If your employer makes a contribution to your IRA that exceeds the annual limit, your employer may correct the error with your consent, by requesting that a distribution of the excess and its earnings be returned to your employer. If the excess amount and the related earnings are returned to your employer, it is not included in your taxable income. Although rare, it’s possible that your employer may leave the excess contribution in your IRA.

**15. Q. Do I need to file any additional forms with the IRS because I participate in a SEP plan?**

A. No.

**16. Q. Is my Employer required to provide me with information about IRAs and the SEP Plan?**

A. Yes. Your Employer must provide you with a notice that a SEP plan has been established (the *SEP Summary for Employees*), along with this *Employee Information* sheet, and give you a statement each year showing any contribution to your IRA.

**17. Q. Is the financial organization where I establish my IRA also required to provide me with information?**

A. Yes. It must provide you with a disclosure statement which contains the following information in plain, nontechnical language:

- (1) the statutory requirements which relate to your IRA;
- (2) the tax consequences which follow the exercise of various options and what those options are;
- (3) eligibility rules and rules on the deductibility and nondeductibility of retirement savings;
- (4) the circumstances and procedures under which you may revoke your IRA, including the name, address, and telephone number of the person designated to receive notice of revocation (this explanation must be prominently displayed at the beginning of the disclosure statement);
- (5) explanations of when penalties may be assessed against you because of specified prohibited or penalized activities concerning your IRA; and
- (6) financial disclosure information which:
  - (a) either projects the growth in value of your IRA under various contribution and retirement schedules, or describes the method of computing and allocating annual earnings and charges which may be assessed;
  - (b) describes whether, and for what period the growth projections for the plan are guaranteed, or a statement of the earnings rate and terms on which the projection is based;
  - (c) states the sales commission to be charged in each year expressed as a percentage of \$1,000 (basis points); and
  - (d) states the proportional amount of any nondeductible life insurance which may be a feature of your IRA.

For a more complete explanation of the disclosure requirements, see Publication 590-A, *Contributions to Individual Retirement Arrangements (IRAs)*, available at most IRS offices.

In addition to the disclosure statement, the financial organization is required to provide you with a financial statement each year. It may be necessary to retain and refer to statements for more than one year in order to evaluate the investment performance of the IRA, and so you will know how to report IRA distributions for tax purposes.

**18. Q. My Employer has indicated in the SEP Summary for Employees that contributions will be allocated using the “integrated formula.” What does this mean and how does it affect me?**

A. If the Plan uses the integrated formula, the Employer contribution for Employees who have Compensation in excess of the integration level will be a higher percentage than the contribution made for Employees whose Compensation is below the integration level. The integration level is indicated on the *SEP Summary for Employees*.

Allocating contributions under the integrated formula involves a four-step process, which is explained below.

**STEP 1:** An amount is allocated for each eligible Employee not in excess of three percent of the Employee’s total Compensation.

**STEP 2:** Eligible Employees with Compensation greater than the integration level receive an allocation not in excess of three percent of their Compensation above the integration level.

**STEP 3:** Any Employer contribution remaining after the allocation in Step 2 is allocated pro rata to each eligible Employee based on the sum of the Employee’s total Compensation plus his or her Compensation above the integration level. The percentage allocated in this step cannot be more than a certain amount, which varies depending upon the integration level selected, as described below:

If the integration level is:	The maximum percentage which can be allocated in Step 3 is:
Taxable Wage Base (TWB)	2.7%
Not more than 20% of TWB	2.7%
More than 20% of TWB but not more than 80% of TWB	1.3%
More than 80% of TWB	2.4%

**STEP 4:** Any Employer contribution remaining after the allocation in Step 3 is allocated pro rata to eligible Employees based on their total Compensation.

**EXAMPLE:** The Big Apple Corporation maintains a SEP plan which uses the integrated allocation formula. The integration level is the taxable wage base (\$137,700 for 2020 and \$142,800 for 2021). For 2021, the company will make a contribution of \$20,000. Listed below are the qualifying participants of Big Apple Corporation and their Compensation. The chart below shows how the Employer Contribution will be allocated to the IRAs of eligible Employees.

EMPLOYEE	COMPENSATION	Step 1	Step 2	Step 3	Step 4	Total Allocation	Allocation as a % of Comp.
SUE	\$190,000	\$5,700	\$1,416	\$6,404	\$1,442	\$14,962	7.9%
SAL	58,000	1,740	0	1,566	440	3,746	6.5%
SAM	20,000	600	0	540	152	1,292	6.5%
<b>TOTAL</b>	<b>\$268,000</b>	<b>\$8,040</b>	<b>\$1,416</b>	<b>\$8,510</b>	<b>\$2,034</b>	<b>\$20,000</b>	
REMAINING TO BE ALLOCATED	\$20,000	\$11,960	\$10,544	\$2,034			